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# FEES PAID TO SYNDICATORS OF QUALIFIED AFFORDABLE HOUSING INVESTMENT FUNDS

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## Overview

In May 2014, the Financial Accounting Standards Board ("FASB") issued ASU 2014-09, which modified the accounting under ASC Topic 606 *Revenue from Contracts with Customers* ("Topic 606"). These modifications become effective for non-public entities' annual reporting periods beginning after Dec. 15, 2018.

The core principle under Topic 606 is that revenue is recognized "to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services."[1] Recognition of revenues under Topic 606 in accordance with the above core principle is based on application of a five-step process, which is summarized below:

**Step 1: Identify the contract with a customer**
**Step 2: Identify the performance obligations in the contract**
**Step 3: Determine the transaction price**
**Step 4: Allocate the transaction price to the performance obligations in the contract**
**Step 5: Recognize revenue when (or as) the entity satisfies a performance obligation**

This publication will highlight some of the important considerations within each of the five steps and decisions for syndication firms of qualified affordable housing investment funds when recognizing revenue under Topic 606.

## Identifying the customer and the contract

Funds are ordinarily created through the execution of a capital contribution agreement or similar agreement. The agreement specifies fees to be collected from the investor party to be paid to the syndicator party. The customer in this agreement is the LP investor in the fund.

## Identifying the performance obligations within the contract

In identifying performance obligations, ASC 606-10-25-22 addresses situations where a promised good or service is not distinct. In such situations, it requires the entity to combine goods and services with other goods or services until it identifies a combination of goods or services that is distinct.

To be considered distinct, the good or service must meet both of the criteria set forth in ASC 606-10-25-19, which states:

> *A good or service that is promised to a customer is distinct if both of the following criteria are met:*
>
> *a. The customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer (that is, the good or service is capable of being distinct).*
>
> *b. The entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract (that is, the promise to transfer the good or service is distinct within the context of the contract).*

[1] ASC 606-10-05-03

ASC 606-10-25-20 provides additional clarification of the above and states, in part:

> *A readily available resource is a good or service that is sold separately (by the entity or another entity) or a resource that the customer has already obtained from the entity (including goods or services that the entity will have already transferred to the customer under the contract) or from other transactions or events.*

Real estate partnership agreements typically include multiple promises of services to be performed by the syndicator. These promises usually include activities the syndicator will perform to start up the investment fund, obtain investor capital, and acquire qualifying investments. Historically, the fees for these activities were accounted for under the guidance provided in ASC 970-605-30, which is superseded by Topic 606. ASC 970-605-30 codified decisions reached by the FASB in SOP 92-1, which established syndication activities, the raising of equity, as a service for which revenue could be recognized independently.

The promise associated with the creation of the fund is to enable the LP investor to become an equity investee specifically in qualified affordable housing properties. Because the LP investor cannot obtain substantially all of the economic benefits of the organization of the fund without the acquisition of qualifying properties, a syndicator would likely conclude that the organization of the fund and the acquisition of (or transfer of) properties are not distinct on their own, and should be combined into a single performance obligation.

Other promises are frequently included in a syndication agreement that may be distinct and separately identifiable from the syndication performance obligation. Examples include asset management services, developer management, and tax credit assignment services.

## Determining the transaction price

The transaction price under Topic 606 includes all consideration to which the entity expects to be entitled in exchange for transferring promised goods or services to a customer. Such consideration may include fixed amounts, variable amounts, or both. The nature, timing, and amount of consideration promised by a customer can affect the transaction price, as described in ASC 606-10-32-3, which states:

> *When determining the transaction price, an entity shall consider the effects of all of the following:*
>
> a. *Variable consideration*
> b. *Constraining estimates of variable consideration*
> c. *The existence of a significant financing component in the contract*
> d. *Non-cash consideration*
> e. *Consideration payable to a customer*

Variable consideration, when present, must be estimated by the reporting entity to arrive at the transaction price. Furthermore, the estimate of variable consideration may need to be what Topic 606 describes as "constrained,"[2] whereby a portion of the variable consideration estimated is not included in the transaction price until it is "probable that a significant reversal in the amount of cumulative revenue recognized will not occur," the update notes. Syndicators often structure the syndication and other fees

[2] ASC 606-10-32-3b, ASC 606-10-32-11 through 32-12

to be calculated amounts rather than fixed amounts alone. In such arrangements, a component of the transaction price is variable consideration that must be estimated. Depending on how an agreement is written, a syndicator may need to estimate how much of the working capital reserve ("WCR") will be used to provide for up-front fees, manage the fund, and apply the constraint(s).

Because they represent non-cash consideration, partnership interests included in the consideration the syndicator expects to receive may also be variable consideration that requires estimation of their expected value when they will be transferred.

## Allocating the transaction price

Prior to the effective date of Topic 606, the industry-related guidance for syndication included requirements to prevent allocating a more-than-reasonable amount of the consideration promised in the contract to syndication, which potentially would have led to recognizing an inappropriate amount of revenue at the point the syndication activities in the agreement were complete. Specifically, the guidance required that if stated syndication fees are not reasonable, they must be adjusted for accounting purposes to amounts that are reasonable, and the adjustments shall be allocated to or from the real estate sales portion of the transaction. Reasonable under the superseded guidance meant that the consideration fell within the range of syndication fees charged by independent brokers in similar transactions and at least adequate to reimburse the syndicator for amounts paid to independent brokers or other third parties associated with the transaction.

Under Topic 606, the transaction price, which in total includes fixed consideration amounts and estimated variable consideration amounts, is allocated to the distinct performance obligations based on their relative stand-alone selling prices. If any performance obligations are not sold stand-alone, the stand-alone selling prices must be estimated, so that an appropriate allocation can be made. We believe the requirements in Topic 606 for allocation of the transaction price are similar in nature to the superseded requirements in ASC 970-605, in that the estimation of the stand-alone selling price for the syndication performance obligation will continue to apply understanding of prices paid within the marketplace to independent brokers in similar transactions. However, under Topic 606, the stand-alone selling prices for both the syndication and non-syndication performance obligations must be known to appropriately allocate the transaction price. Care must be taken to perform estimation that takes into account variable consideration that might be attributable to only one or more performance obligations identified in the contract but not all of them.

## Recognizing revenue as the performance obligations are satisfied

Topic 606 requires revenue to be recognized when, or as, the entity satisfies the performance obligation, which culminates with transfer of control of the promised good or service to the customer.[3] An entity must determine at contract inception whether the performance obligations are satisfied over time or at a point in time.[4]

On the premise that the customer cannot benefit from syndication services until the fund is organized and has acquired qualifying affordable housing investments, point-in-time revenue recognition would be appropriate when the acquisition of qualifying investments is complete.

[3] ASC 606-10-25-23
[4] ASC 606-10-25-24

Revenue recognition for other services promised in the agreement, including asset management services, may be more appropriately recognized over time rather than at a point in time. To recognize revenue over time, at least one of the three criteria set forth in ASC 606-10-25-27 must be met. Those criteria are:

1. *The customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs.*

2. *The entity's performance creates or enhances an asset … that the customer controls as the asset is created or enhanced.*

3. *The entity's performance does not create an asset with an alternative use to the entity, and the entity has an enforceable right to payment for the performance completed to date.*

Other services promised in the syndication agreement may meet criteria 2 and 3 described above. However, careful consideration should be made as to whether the benefits created by the service can be consumed or controlled as the service is being performed.[5]

[5] ASC 606-10-25-25

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